COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF PUBLIC UTILITIES

Notice of Inquiry/Rulemaking on Electric Industry Restructuring	D.P.U. 96-100

Comments of the Competitive Power Coalition of New England

The Competitive Power Coalition of New England ("CPC") is a New England-based organization of independent power producers, cogenerators and power marketers. CPC is pleased to offer these comments on the proposed rules and issues raised by the Department of Public Utilities ("Department") in its May 1st order in D.P.U. 96-100 ("Order"), the Department's investigation into restructuring of the electric industry in Massachusetts.

In our comments, we address four sets of issues raised by the Department's Order: (1) the overall framework laid out by the Department in D.P.U. 96-100; (2) key elements in the structure and operations of the regional market in which Massachusetts companies compete; (3) key issues in restructuring of vertical integrated electric companies, and in offering customer choice through unbundled retail electric service; and (4) the treatment of key policy issues, such as environmental comparability and generation from renewable resources.

I. The Overall Framework For Competition in the Electric Industry

In light of CPC's long-standing advocacy of a fully competitive electricity market, CPC enthusiastically supports the

overall framework proposed by the Department in D.P.U. 96-100. In important ways, the vision articulated in the Department's Order is quite close to the one described by CPC in its *Blueprint for a Competitive Electricity Supply System in New England* (January 5, 1996) ("Blueprint") and its April 12, 1996 comments in this proceeding.[1]

In particular, the Department's vision of a restructured industry and the industry envisioned in the CPC Blueprint and April comments share the following key features: a competitive wholesale market in the region, with an independent system operator; a generation market supplied through bilateral contracts and voluntary power exchanges; a unified regional transmission tariff, offering non-discriminatory open access to transmission; the functional separation of generation, transmission, retail marketing, and distribution, with strict rules for inter-affiliate transactions; retail wheeling and equal access to consumers; incentives to encourage voluntary divestiture of utility assets to promote a competitive structure; environmental comparability and support for renewables; a reasonable opportunity to collect "transition costs" through a non-bypassable system access charge; performance-based, price-cap rate regulation for the distribution business; and protections to

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[1] CPC's *Blueprint for a Competitive Electricity Supply System in New England* was submitted to the Department on April 12, 1996, as Attachment A to the CPC Comments in D.P.U. 96-100.

ensure reliable and affordable electric service to all Massachusetts consumers.

The Department's vision and the proposed regulations and commitments designed to support that vision recognize appropriately that the success of the electricity market in Massachusetts is integrally tied to the shape and texture of the wholesale market in New England. Rather than carve out a structure for Massachusetts as if the Commonwealth operated in isolation from the rest of the region, the Department properly endorses and embraces elements of a restructured *regional* electric industry, even where the Department lacks authority to unilaterally shape policy in wholesale electricity markets and regional environmental protection strategies.

What CPC finds especially refreshing in the Department's vision is that it properly combines boldness and restraint. Throughout its Order the Department states its preferences regarding policy on issues that are under the jurisdiction of other federal and state economic and environmental policymakers; attempts to craft rules for Massachusetts electric companies to operate within a regional model consistent with those preferences; and then commits to work outside of the boundaries of its hearing rooms to help advance its policy preferences in those arenas under others' authority.

Such a direct, straightforward approach is essential to enabling the Department to realize it own vision for Massachusetts. Recognizing that non-discriminatory access to

transmission is essential to the accomplishment of the Department's own goals for Massachusetts consumers, the Department appropriately and helpfully clarifies jurisdiction over distribution and transmission. This clarification affords an opportunity for a smooth transition to competition, while reducing the potential for litigation over state/federal jurisdictional boundaries that could slow and impede the introduction of robust competition into the regional market.

The Department also demonstrates leadership in committing to work cooperatively with the Massachusetts legislature, and with other decisionmakers -- with sister agencies in Massachusetts and in neighboring states in the region, and with federal agencies in Washington -- to accomplish the goal of an efficient industry structure and regulatory framework. And, while as it will be important for these other policymakers and players in the commercial markets to embrace and help shape the kind of changes envisioned by the Department, the Department recognizes that it will be equally important for the Department itself to deliver on its commitments to work with others. CPC applauds the Department's commitment, and offers to help work together to realize the efficient industry structure necessary for the benefits of competition to flow to consumers in Massachusetts.

II. The Framework for the Regional Electricity Market

A. Introduction

In this section, CPC addresses the major elements of the Department's framework for the regional electricity market in the

future. Just as Massachusetts is part of a tightly functioning electric industry today, this regional framework is the background against and in which the retail competitive market will shape itself in the future. The Department appropriately describes the features of this regional terrain, since these features are essential to the successful performance of a competitive electricity market for retail consumers in the years to come.

Notwithstanding the limits to the Department's jurisdiction to shape this terrain, the Department has taken a critical step in listening to parties' ideas, outlining a regional vision, designing and proposing to move toward a competitive structure for retail choice aligned with the regional vision, and then committing to roll up its sleeves to help private parties and other policymakers deliver their portions of the regional framework.

B. FERC Order 888

1. General Policy

CPC agrees with the Department that the competitive industry framework outlined in D,P.U. 96-100 generally aligns with the final open access transmission and stranded cost rules[2] published by the Federal Energy Regulatory Commission ("FERC") on April 25,

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[2] FERC Order No. 888, Final Order Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, Docket No. RM95-8-000, and Recovery of Stranded Cost by Public Utilities and Transmitting Utilities, Docket No. RM94-7-001.

1996 ("Order 888"), and FERC's companion rule in Establishing Open Access Same Time Information System and Standards of Conduct, FERC Order 889 ("Order 889").

FERC's final rules set out federal policy on various elements included in the Department's vision: the unbundling of transmission from generation; the terms and conditions of provision of non-discriminatory transmission and ancillary services; a requirement for functional but not corporate unbundling; rules of conduct for affiliate transactions; transmission system information availability on the electronic bulletin board; modifications in existing coordination agreements, such as power pools and holding companies, so as to remove discriminatory treatment of certain preferential transactions in the use of transmission facilities; exclusive federal jurisdiction over transmission in interstate commerce; and guidance for independent system operators ("ISOs").

In response to the Department's request for comment on the implications of FERC Order 888 on the Department's proposed regulations for Massachusetts electric companies, CPC discusses several issues regarding jurisdiction over transmission; transmission and coordination agreements; and independent system operators.

2. Jurisdiction Over Transmission

Even with the remaining uncertainties[3] to be resolved in the near future by the FERC, the Department appropriately interprets the FERC framework as a workable framework for moving from bundled to unbundled services.

CPC agrees with the Department when it recognizes in D.P.U. 96-100 (See Order at 6, 18-19) that FERC's final rules properly provide for: undisputed FERC jurisdiction over transmission in interstate commerce; assertions of FERC jurisdiction over unbundled retail transmission in interstate commerce when such unbundling occurs as a result of state action; descriptions of the characteristics of facilities which help to distinguish transmission service from distribution service; and a finding that every retail electric transaction, i.e., service to an ultimate customer, in any state includes a component that is jurisdictional to state regulators.

CPC agrees fully with this framework and applauds both the FERC and the Department in this regard. CPC especially appreciates that the Department has taken the commendable step of committing to work with FERC to continue to draw lines to clarify differences on specific transmission and distribution facilities

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[3] CPC notes that Order 888 leaves open a number of important questions regarding implementation of pricing of certain transmission services; policy for release of transmission capacity; application of ISO guidance to compliance filings made by tight power pools and holding companies on or before December 31, 1996; and market pricing for existing generation.

so as to accommodate and facilitate a competitive electric industry structure.

To help the Department satisfy its goal that every retail electricity transaction in Massachusetts include a component that is jurisdictional to the Department so that its policy requirements will not be bypassable, we urge the Department to focus on two critical issues. First, the Department should add a provision in its regulations to define "retail customer" as the entity from whom General Access Charges and Transition charges are collected. CPC suggests that the following definitions be included in proposed rule 220 CMR 11.02:

> Distribution shall mean the delivery of power from the transmission system to a retail customer within Massachusetts.
>
> General Access Charge shall mean the charge assessed to retail customers that provides the mechanism by which a Distribution Company will recover its costs for public policy goals, including discounts for low-income customers and funding for energy efficiency and renewable resources.
>
> Retail Customer shall mean an end user of electricity in Massachusetts who uses generation, transmission or distribution services provided by another entity and who pays a General Access Charge and a Stranded Cost Access Charge as long as such charges are assessed.
>
> Stranded Cost Access Charge shall mean the charge assessed to retail customers that provides the mechanism for recovery of a utility's Stranded Costs, as defined in 220 CMR 11.03(2).
>
> Transmission shall means the delivery of power from generating units across interconnected high voltage facilities to point where the power enters the distribution system or serves a retail customer. Transmission is under the jurisdiction of the FERC. See also, FERC Order No. 888.

Secondly, in these proposed language changes, we urge the Department to refrain from referring to a 69 kilovolt voltage level in the definitions of transmission and distribution facilities. Because the Department's proposed language for defining distribution and transmission in 220 CMR 11.02 remains relatively vague, in that it describes the 69 kilovolt level as the level "typically" distinguishing a break between transmission-level and distribution-level service, the proposed language does not offer greater clarity beyond the descriptions of distribution service offered in Order 888. If references to 69 kilovolts are retained in the Department's regulations, such language may create an incentive for some customers to bypass distribution through interconnection to the grid at a voltage level above 69 kilovolts. In CPC's view, this potential behavior by certain customers would be wholly inconsistent with the Department's goal that all retail customers have a component of their service that is jurisdictional to the Department.

3. Transmission and Coordination Agreements

CPC agrees with the Department's expectations that distinctions between transmission for own load use and transmission for others will diminish and wither away in the future, especially as FERC implements Order 888 with regard to coordination agreements. Both FERC Order 888 and D.P.U. 96-100 identify the maintenance of preferential treatment of certain transactions in some existing coordination agreements (e.g., tight power pools, such as the New England Power Pool ("NEPOOL"),

and holding companies with generation and transmission agreements) as inconsistent with FERC's policy to require non-discriminatory open-access transmission. CPC supports the Department's agreement with FERC's view that "in order to adequately remedy the undue discrimination in transmission access and pricing by public utilities that are members of power pools and other coordination agreements, such public utilities must remove preferential transmission access and pricing provisions from agreements governing their transactions." (Order 888, Section I.F)

CPC applauds FERC's requirement that the members of tight power pools file joint, pool-wide transmission tariffs and revisions to their pooling agreements by December 31, 1996. CPC agrees with the Department that the development of a fully competitive market for generation requires changes in the NEPOOL Agreement beyond those currently being contemplated by the members of NEPOOL. Although both CPC and the Department recognize that the NEPOOL Agreement falls under FERC's jurisdiction, CPC urges the Department to do everything in its authority to ensure that Massachusetts electric companies, as members of NEPOOL, cooperate fully with this FERC directive to propose meaningful and satisfactory changes to the NEPOOL Agreement.

CPC is concerned, however, that there may be inherent limitations in the ability of Massachusetts electric companies, or any other set of NEPOOL members, to willingly renegotiate the

removal of certain discriminatory provisions in the NEPOOL Agreement which presently afford them preferential treatment.

These privileges extend not only to the terms and conditions of certain transmission service, but also to the voting rules of the organization itself. The very rules under which NEPOOL operates and makes policy decisions effectively permit the exercise of veto power by certain companies or blocks of companies voting together. New market entrants seeking to compete with the members of NEPOOL in the future commercial market in New England do not even have the right to vote in NEPOOL decisions. Even if such suppliers can hope to participate in a fully competitive market in the future, today they are not allowed to vote on any modifications to NEPOOL rules, even though, under FERC's framework, the revisions to the NEPOOL Agreements due in December 1996 are intended to be the means by which existing coordination arrangements are modified to remove discriminatory provisions.

While CPC is relatively confident that FERC will carefully evaluate the NEPOOL members' joint compliance filing according to the tests of non-discriminatory transmission service set forth in Order 888, CPC is nonetheless skeptical about the ability of the NEPOOL members, voting on their own, to make satisfactory changes between now and December. If they cannot, then FERC will surely take whatever steps are necessary after the NEPOOL filing is made to ensure non-discriminatory access to and use of transmission.

However, any FERC process will be a time-consuming and resource-consuming process.

To expedite and increase the chances for a successful resolution of this issue in the near term, CPC urges the Department to employ whatever formal and informal authority it possesses to create incentives for Massachusetts electric companies to make the types of meaningful changes that are necessary to comply with FERC's order.[4]

As the Department rightly observes, these changes involve issues relating to the pricing and operations of the transmission facilities in the region. Since, in New England, most of these issues relate to the role and functions of an independent system operator, market exchange functions, and the relationship between these entities and the participants in the commercial market, CPC addresses these issues below.

C. Independent System Operator

In moving from a regulated electricity market to a competitive market structure supported by strategic regulation of transmission and distribution, the Department rightly identifies the critical need to ensure that the reliability benefit offered

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[4] CPC urges the DPU to reconsider its proposal in D.P.U. 96-100 to encourage retention of such preferential treatment if a loss of it were a disincentive to a utility's divestiture of generation assets. The Department should refrain from encouraging divestiture at the expense of the realization of other important features of a competitive market such as those types of open access transmission that FERC has identified as unduly discriminatory. The Department should use other means to create incentives for divestiture.

historically by NEPOOL not be lost in the transition. CPC agrees that competition without reliability is an unworthy goal. Indeed, CPC points to the critical role that an ISO must play in the future in ensuring reliability, as it also helps ensure non-discriminatory use of transmission.

As CPC stated in its Blueprint, "competition will flourish when there is the separation between the market participants that utilize the transmission network and those that operate the network". Blueprint at 2. Since the initiation of this restructuring proceeding, CPC has been an advocate of a truly independent ISO, one that operates the transmission network to accommodate transactions of market participants and supports the services required to maintain system reliability.

CPC is pleased that the Department agrees that a "market structure....is characterized by a bulk power system operator ("ISO"), that is truly independent of participants in the market .... [and] must be responsible, at a minimum, for those activities necessary to ensure that NPCC [Northeast Power Coordinating Council] and NERC [North American Electric Reliability Council] reliability standards will continue to be met." D.P.U. 96-100, at 13.

While CPC is disappointed that FERC declined to require tight power pools to form ISOs, CPC notes FERC's clear intent in its suggestion that an ISO might be useful as a means of remedying undue discrimination in transmission access. Moreover, FERC's issuance of fairly detailed guidance on appropriate

features of an ISO makes it clear to CPC that FERC intends to review proposed modifications to power pool agreements with this guidance in mind. FERC's guidance includes features relating to:

(1) the responsibilities of an ISO, including all matters relating to:

* short-term system reliability of the grid operation;

* control over interconnected transmission facilities; and

* mechanisms to coordinate with neighboring control areas.

(2) transmission pricing, including

* non-pancaked rates, under a single unbundled grid-wide tariff for transmission and ancillary services;

* pricing policy for transmission and ancillary services that promotes efficient use of the grid; and

* adoption of operation and trading rules to relieve transmission congestion.

(3) institutional issues associated with separating the operating of the grid from the commercial transactions in the marketplace, including

* governance rules structured in a non-discriminatory way;

* severance of any financial ties between the ISO and its employees from the participants in the power market; and

* posting of information on transmission availability on the open-access real time information system ("OASIS") so that all users, including affiliates of companies that own

transmission, have access to the same information and obtain it from the bulletin board.

In CPC's view, the ISO is the vital cornerstone which both can transform NEPOOL and retain its benefits. The FERC's ISO guidance, along with FERC's requirement that members of tight power pools file individual open-access tariffs in the short run, and joint pool-wide tariffs by the end of 1996, should offer the Department comfort that the reliability benefits of NEPOOL will not be lost in the transition to a competitive industry structure.

Clearly, a truly independent system operator is the preferred means to meet FERC's nondiscriminatory open-access requirement. The ISO offers operational unbundling -- separating the operations of the transmission system from financial interests in the commercial market. This operational unbundling is key, given FERC's final rules and the Department's proposed rules that permit the persistence of vertically integrated utility companies which continue to own transmission, generation, and distribution assets. Operational unbundling through an ISO also assists in diminishing vertical market power problems that would otherwise persist within a NEPOOL-like arrangement where policy is set by a governing board with rules structured to give special weight to the views and interests of particular members.

In addition to strongly advocating for a truly independent ISO, CPC offers the following comments on issues raised by the Department:

- Corporate separation of the ISO from the commercial interests in load and generation is essential. It simply is not enough to have voting rules. As long as NEPOOL remains a membership organization with votes weighted by load served by the supplier, and as long as new entrants in the load-supplying business can neither serve retail load at present,[5] nor even begin to offer truly comparable service to end users without comparable access to transmission, it is hard to imagine a set of voting rules for NEPOOL that would be fair to all suppliers seeking to use the grid for wholesale and retail transactions on a non-discriminatory basis. Therefore, the ISO needs to be separate from the interests in load and generation, and can function effectively as a profit-making organization. In any case, CPC believes that the ISO should not be a government organization.
- The ISO should not be involved in establishing unit commitment; it implements unit commitment.
- CPC can see no reason why the configuration of generation, load and transmission in New England would inhibit the operation of an ISO. The ISO would put in

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[5] Even with the adoption of retail choice in Massachusetts, such choice will not commence until 1998. In that year, only a small portion of New England's retail customers will have choice, so incumbent utilities will have a lock on the factor that allows for voting under NEPOOL rules.

place procedures for day-ahead and real-time (e.g., hour-ahead or quarter-hour-ahead) unit commitment for transactions from market participants. The ISO would have in place policies, procedures, and protocols for curtailing load or generation in emergency conditions, and for allowing market participants to trade transmission under normal operating conditions.

- The ISO would dispatch unit commitments from all pre-scheduled bilateral contracts and market exchange schedules within a control area and over transmission ties to neighboring areas. All transactions -- whether from contracts or from other market participation -- must be presented to the ISO in the same fashion, and treated in a non-discriminatory fashion.
- The ISO should not dispatch the units of the system for overall economic efficiency, or for the purpose of generating a pot of pool-wide savings. Competition among suppliers will provide for economic efficiency and will allocate these efficiencies.
- The ISO should control all assets in a control area that are absolutely necessary to carry out its reliability function, but only those assets, and none others.
- The ISO should provide only those ancillary services that must be centrally provided by the ISO. Other ancillary services that can be provided through the

market should be provided by the market, rather than by the ISO.

- The ISO should provide information on load and transmission availability at different locations on the grid, in the form of both of short term information on OASIS, and periodically provided long-term forecasts of load, transmission, and reliability. This information would be available to all market participants so that they can use it as they see fit for business planning reasons.

CPC urges the Department to find that a truly independent ISO is needed as an essential feature of a competitive market structure in Massachusetts and New England. The CPC further urges the Department to negotiate immediately with parties in New England to advance modifications to the NEPOOL Agreement consistent with these findings.

D. Power Exchange

In its Blueprint and April 12, 1996 comments, CPC envisions a commercial electricity market similar to that envisioned by the Department: a market involving transactions among parties to bilateral contracts and transactions among parties that voluntarily participate in spot and forward markets. A forward market would permit hedging against price and delivery uncertainty, and a spot market would allow many buyers and sellers to transact electricity for near term delivery in as short a time as fifteen minutes, ensuring instantaneous

availability of electricity at prices reflecting supply and demand.

In D.P.U. 96-100, the Department has presented its initial view that a voluntary power exchange might be needed to facilitate a short-term market for energy transactions, at least during some transition period, in order to price the energy portion of a distribution company's offering of Basic Service, where that distribution company remains part of a vertically integrated utility.

In response to the Department's question about whether distribution companies must meet their requirements for supplying Basic Service customers from a power exchange, CPC offers the following comments:

- If the Department finds that a power exchange is necessary, participation in it should be voluntary, and the power exchange itself should be subject to some sort of "sunset provision." Such a provision would recognize the expectation that other market entities ultimately will arise to fulfill the transitional role of the power exchange.
- There could be more than one power exchange.
- The power exchange should be institutionally and financially separate from the ISO, and from other commercial interests in the market.
- Transactions undertaken through a power exchange should have the same status before the ISO as bilateral

transactions or transactions from another exchange. Each type of transaction will be subject to the same physical nomination protocols and will use the same communications interface with the ISO.

- Presuming the Department allows various suppliers to become certified to have the right to supply Basic Service customers, with customers allocated according to some fair allocation method, then those suppliers would decide whether to supply service through forward instruments or through the spot market. (See discussion in Section III.E, below.)

III. A Competitive Market In Massachusetts

A. Introduction

Having addressed the major regional issues identified by the Department which form the framework of a competitive market, CPC next addresses the specific issues associated with the restructured electric industry in Massachusetts -- issues that form the basis of the Department's proposed regulations. In these comments, CPC focuses primarily on the following issues: (1) functional separation; (2) incentives for electric companies to divest generating assets; (3) rules governing interaffiliate transactions; (4) provision of basic service; and (5) mechanisms for stranded cost recovery.

Before addressing these five issues and associated proposed regulations individually, it is useful to step back and describe how these individual rules will need to interact in order to

allow for a workable competitive system in Massachusetts. In the same way that FERC Order 888 and proposals to reform NEPOOL provide an overall framework for competition, the major provisions of the Department's rules also must interact so as to create the optimal conditions for competition to flourish. An understanding of the role of each component of the proposed rules in fostering competition provides guidance on how the Department might fine-tune the language in its proposed rules to meet its objective more effectively.

CPC maintains that the primary purpose of the Department's proposed rules is to eliminate obstacles to true competition. Customer choice is a valuable option for customers only if a truly competitive market for generation exists. Without true market conditions, freedom of choice is not meaningful. As the Department points out numerous times in its Order, the single greatest obstacle to achieving a competitive market is the vertical monopoly power of today's utilities. The existing vertical monopoly power of utilities presents an absolute bar to retail competition in the generation market. Breaking up the existing vertical monopoly power of the utilities is the *sine qua non* of meaningful competition.

The February 1996 filings by Massachusetts utilities provide a clear demonstration of how most electric companies will continue to use vertical monopoly power to all but eliminate competition. The February utility filings, particularly the plans sponsored by Massachusetts Electric Company and Boston

Edison Company, reflect this overall strategy. The first element of these utilities' strategy is to classify all existing generation, and some future costs, as stranded costs. This approach effectively shields these costs from competition by including them in monopoly rates, as is the case with the status quo. As a result, the utilities' generation costs would be largely subsidized by monopoly ratepayers, an advantage which other competitors simply do not have. The second element of the utilities' strategy is to market aggressively a bundled service that includes monopoly services and generation -- the so-called "standard offer." The utility plans tout this standard offer as a great deal for ratepayers even though the offer amounts to today's rates with an annual increase for inflation. The utilities' marketing resources will doubtlessly enable them to sell this standard offer to many consumers, particularly less sophisticated customers. The standard offer may be marketed successfully to even those customers who seek alternatives more actively, since these customers may have trouble finding any significant overall savings in the marketplace in the short-term when non-bypassable access charges will be relatively high.

CPC agrees with the Department that vertical monopoly power must be broken in order to achieve the benefits of competition in the generation market. CPC consistently has maintained that the best way to eliminate the problems associated with vertical monopoly power is for utilities to divest generation assets. CPC acknowledges that the Department does not have the authority

under current law to order such divestiture. Therefore, a "second-best solution" would include a variety of measures similar to those measures which the Department has included in its proposed rules -- i.e., functional separation, operational separation of transmission by virtue of the ISO, incentives for divestiture, rules on affiliate transactions, and restrictions on the provision of basic service. In combination, these rules must be sufficiently strict to prevent the utilities from implementing the strategies which are set forth in their February 1996 filings. In Sections III.B through III.F, below, CPC discusses some specific amendments to the proposed regulations which are consistent with this objective.

The other key aspect of a restructured electricity market is the treatment of stranded costs. CPC consistently has taken the position that utilities are entitled to a reasonable opportunity to recover stranded costs. However, any costs recovered from ratepayers must be truly stranded. The utilities' February 1996 filings merely treated all embedded costs and some future costs as stranded, without considering any form of mitigation. Under the utilities' definition of stranded costs, most generation costs will continue to be recovered in monopoly rates, thereby making competition meaningless.

Recovery of stranded costs must be done in a way that does not create a subsidy of utilities' generation assets from monopoly ratepayers. Therefore, any rules of stranded cost recovery must reflect two important principles: (1) a recognition

of the market value of current utility assets, and (2) a prohibition against inclusion of the going-forward costs of utility generation, including both incremental fixed and variable costs. Notably, the Department's regulations incorporate these two principles. The comments which follow provide a few suggestions to fine-tune the Department's language. The comments also include an alternative treatment of long-term power contracts that is consistent with the position taken by both the utilities and DOER, as well as a proposal to address the issues particular to nuclear generation.

The objective of CPC and the Department in this proceeding is clear -- the emergence of a competitive marketplace with many sellers of generation competing on equal terms. In the context of this shared vision, the sections that follow set forth CPC's specific comments on the proposed regulations.

B. Functional Separation

The Department correctly deems functional separation as the "minimum acceptable approach" necessary to address the issue of market power and allow true competition. Order at 26. The Department defines functional separation as "the creation of separate corporate entities (e.g., generation, transmission, marketing, and distribution subsidiaries) under one holding company." Id.

In a later section of its Order, the Department notes that a necessary component of functional separation is the unbundling of rates into the functional components of distribution,

transmission and generation. Id. at 50-52. The Department orders that this functional separation of rates be performed in a manner consistent with the FERC Uniform System Of Accounts. Id. at 51. The Department then reiterates its directive that utilities file unbundled rates by October 7, 1996.

CPC agrees with the Department that this combination of functional separation and unbundling of rates is one of the necessary requirements for preventing the continuation of utility vertical market power. However, CPC believes that the Department should impose at least two additional requirements with respect to corporate separation in order to provide meaningful protection against market power abuse. First, the Department should require that the generation entity (and marketing entity, as well) be located in a different building from the "monopoly" entities. It is clearly the case that it will be very difficult to police the exchange of information between affiliated entities, particularly when some entities are regulated and some are not. The physical separation of the entities into different buildings provides a small degree of protection.

Second, the Department should require that the names of the generation entity (and marketing entity) have no relationship to the name of the current monopoly entity. In other words, entities such as Massachusetts Electric Power or Boston Edison Power, cannot be established if the goal of true competition is to be achieved. It will be very difficult for the Department to monitor the marketing of bundled services by the affiliated

companies. Existing utility companies have enormous and sophisticated marketing organizations with long-standing relationships to customers. There is the risk that all of these personnel will go to the marketing entity and take with them all of the information and the long standing relationships that have developed over the years. Additionally, such personnel, especially customer service personnel, that remain with the distribution company must not market the competitive services offered by their colleagues at the generation company. Even without overt efforts by distribution companies to market generation, the utility generation affiliate will benefit enormously from the name recognition and goodwill that have been developed over the years from utility marketing efforts and customer service programs -- programs which ratepayers have supported. CPC believes that there is no reason for utility generation affiliates to enjoy this significant advantage. Generation and marketing affiliates ought to compete in the marketplace on the basis of criteria like price and quality of service like any other competitor. Requiring these affiliates to select a name that is not associated with the distribution company is not at all burdensome and provides another reasonable way to foster true competition.

With respect to the unbundling of rates, CPC agrees with the Department that the FERC Uniform System of Accounts provides appropriate overall guidelines. However, CPC respectfully urges the Department to provide more specific guidelines for rate

unbundling. CPC's review of the Uniform System of Accounts indicates that some accounts may include costs associated with both monopoly and competitive functions. The appropriate allocation of these costs is clearly of vital concern. Utilities may have the incentive to allocate costs inappropriately to the monopoly functions. Overallocation of costs to monopoly services will constitute a subsidy to the competitive services which, of course, will impair the functioning of a true competitive market.

CPC provides below proposed regulations that address corporate separation and rate unbundling. These regulations are largely based on proposed rules filed previously by DOER. CPC requests that these suggested regulations be inserted at 220 CMR 11.03.

1. Not later than January 1, 1998, all jurisdictional electric companies shall separate the production, transmission and distribution portions of their business. The transmission and distribution company shall not perform marketing functions for their affiliated generation company. The production (and marketing, if any), corporation shall be located in a different building than the transmission and distribution corporations. The name of the production corporation and any marketing corporation shall have no relationship or similarity to the name of the jurisdictional electric company, the transmission corporation, the distribution corporation or the holding company. Each corporation shall keep separate finances and books of account subject to the requirements of the Federal Energy Regulatory Commission ("FERC") and the Department, and shall conform to the Uniform System of Accounts and Generally Accepted Accounting Principles.

2. Each jurisdictional electric company shall allocate its existing electric plant accounts, operation and maintenance ("O&M") expenses, depreciation, working capital, taxes and tax reserves, cost of capital, and revenue and revenue credits into the books of the newly formed production,

transmission and distribution corporations according to the following guidelines:

a. To the production corporation, with the exception of those costs designated as stranded costs pursuant to Section 11.06 of these regulations: FERC Accounts 120; 310 through 346; 447; 500 through 555-557; 911 through 917.

b. To the transmission corporation: FERC Accounts 350 through 359; 560 through 574.

c. To the distribution corporation: FERC Accounts 360 through 373; 580 through 598; 901 through 910.

d. For the remaining FERC Accounts including but not limited to: 105 through 111; 152 through 157; 163; 182; 186; 190; 201 through 218; 221 through 224; 281 through 283; 301 through 303; 389 through 399; 403 through 407; 408.1; 440 through 446; 450 through 456; 920 through 935; and working cash, state and Federal taxes, and income tax deductions, the electric company shall propose a method by which to allocate such accounts to production, transmission, and distribution corporations.

e. Costs designated as stranded costs pursuant to Section 11.06 of these regulations shall be allocated to the distribution corporation. The Department shall determine the appropriate accounting treatment of such costs in accordance with Section 11.06.

3. The Department shall review and approve each jurisdictional electric company's proposed method for corporate and account separation. The Department will allow a reasonable opportunity for interested persons to comment on such plans. The Department will approve such plans only if it finds that the electric utility has fully complied with the requirements of this section and has utilized an objective allocation methodology that does not result in an inappropriate allocation of costs to the distribution and transmission functions.

C. Incentives for Divestiture

CPC consistently has maintained that divestiture of generation is the most effective way to overcome the problems associated with vertical monopoly power. CPC acknowledges that

under current law the Department's options for reducing vertical monopoly power largely are limited to establishing incentives/ disincentives for utility divestiture of generation. CPC fully supports the Department's proposal to incorporate such incentives in the final rules.[6] Order at 55-58. Moreover, the criteria which the Department has proposed for such incentives are reasonable. The Department has stated correctly that such incentives must encourage phased divestiture, avoid depressing the market value of assets and provide utilities with a reasonable opportunity to recover stranded costs.

Developing a series of incentives which achieve these goals is a challenging task. CPC looks forward to exploring this issue during the course of the proceeding with a view toward providing a definitive proposal in its final comments. At this time, we offer the following preliminary comments for the Department's consideration.

First, the incentives for divestiture of generating assets should be linked expressly to stranded cost recovery. CPC believes that divestiture is the optimum way to promote

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[6] CPC does not support the notion that owners of divested generation resources should contract with the distribution affiliate of the company that sold those generating assets. Order at 56. This arrangement would have the very opposite effect which the Department seeks, namely a fully competitive market. Any rule that encourages or otherwise sanctions a continuing relationship between such entities is antithetical to the Department's overriding goals. As we discuss below, all competitors should have an equal opportunity to provide any necessary generation resources to the distribution company.

competition and mitigate stranded costs. Thus, utilities that voluntary divest can be rewarded with more generous stranded cost recovery without undue risk of stifling competition or overcharging ratepayers. This approach poses no threat to competition because divestiture satisfactorily addresses the problems associated with vertical monopoly power. Similarly, there is less concern about overcharges to ratepayers because divestiture is also the most effective way to mitigate stranded costs.

The Department has identified three options designed to encourage divestiture, including mechanisms for stranded cost recovery. Order at 57. CPC supports the Department's full review and consideration of these options, and offers an additional option which may, by itself, or in combination with other options, achieve the Department's divestiture goals. CPC suggests that the Department consider linking divestiture to the level of carrying charges allowed on unamortized balances. Under this option, the Department would set a maximum carrying charge on unamortized balances in 1998 and then reduce the allowed carrying charge in each succeeding year if divestiture targets are not met.

CPC believes that strong incentives to divest are an essential part of the Department's restructuring plan. We look forward to exploring the above proposed incentives and other ideas during the course of this rulemaking proceeding.

D. Corporate Rules of Conduct and Interaffiliate Transactions

The Department's proposed regulations include Rules of Conduct for distribution companies and their affiliates. See 220 CMR 11.06(3). CPC strongly supports these proposed rules. In particular, CPC believes that the requirements to share information with all suppliers are particularly vital. See 220 CMR 11.06(3)(d) and (e). CPC respectfully recommends that the Department adopt an additional rule to prevent a Distribution Company from marketing on behalf of its affiliated generation company.

As discussed previously, utilities have developed extensive, and effective, marketing and customer communication systems. CPC anticipates that much of this infrastructure will remain with the Distribution Company and continue to be supported by the monopoly ratepayers. It would cost competitors millions of dollars to build similar organizations and years to develop the relationship which the utilities share with their customer base. CPC is greatly concerned about the prospect of these marketing organizations, including outside consultants, being employed to promote a Distribution Company's affiliated Supplier. An examination of the utilities' February 1996 filings demonstrates that CPC's fears are well founded. As noted above, an essential element of several utilities plans was the marketing of a bundled service in the form of a standard offer.

Using the marketing and customer services resources of the Distribution Company to market its affiliate's generation is a significant exercise of vertical monopoly power that will result in a substantial subsidy to the utility generation affiliate. The Department's vision assumes that the generation affiliate of a utility must compete with other suppliers on equal terms with no assistance from its affiliated distribution and transmission companies. CPC's earlier recommendation that utility generation affiliates have a separate location and a different name than the Distribution Company is one part of the solution to this problem. Two other elements of the solution are (1) a specific prohibition against a Distribution Company marketing on behalf of its affiliated Supplier, and (2) Department scrutiny of Distribution Company mailings to customers and bill inserts during the transition period to ensure that such documents include no such marketing attempts.

CPC suggests that the Department adopt these two reasonable safeguards by inserting the following language as 220 CMR 11.06(3)(j).

No Distribution Company may conduct any marketing activities jointly with its affiliated Supplier or on behalf of its affiliated Supplier. All information provided by the Distribution Company to its customers relating to industry restructuring and choice of supply shall be reviewed in advance by the Department to ensure that the marketing activities prohibited by this section are not employed.

E. Basic Service

The provision of Basic Service is closely tied with the issue of the Distribution Company offering a bundled service. Section 11.05(2) of the proposed regulations suggests that a Distribution Company can sell, and thus market, distribution and generation services to its customers. As noted above, CPC questions whether it is appropriate for the Distribution Company to market generation in any way. Certainly, the Distribution Company should be prohibited from selling or marketing the generation of its affiliated Supplier except under the limited circumstances described below. Moreover, CPC supports the Department's position that there should be no restriction on the number of times that customers may exit from and return to Basic Service.

Where a Distribution Company is providing Basic Service, the Department's proposed rules set forth two alternatives for the provision of the generation supplies. One is the procurement of power from a Power Exchange. The other is procurement from an individual Supplier subject to Department approval. CPC offers some additional mechanisms, one of which is an alternative version of the Department's second option, the other of which is a new third option. The common feature of these options is a focus on ensuring that competition exists in the supply of power to Basic Service Customers.

In the CPC version of the Department's second option, the Distribution Company has its choice of suppliers with the following constraint: Under this alternative, the Distribution

Company could obtain supplies from any Supplier through bilateral contracts, except for supplies from a generation affiliate. In order to obtain power from an affiliated supplier, the Distribution Company first must employ a bidding procedure that the Department has previously approved as a competitive procurement system. CPC envisions a day-ahead/hour-ahead bidding system quite different from long-term contract procurement processes.

CPC's other alternative would be an arrangement under which Basic Service would be supplied by a variety of suppliers, rather than by the Distribution Company. For the right to supply those customers taking Basic Service, suppliers would need to become certified by the Department as Basic Service Suppliers. In this latter option, the Distribution Company's role is twofold: (1) to deliver supplies to Basic Service customers from alternative Basic Service Suppliers, and (2) to fairly allocate the Basic Service customers among a pool of certified Suppliers.

Accordingly, CPC recommends that the Department adopt the following language as Section 11.05(4)(b)(2):

a. Each Distribution Company without an affiliated Supplier may obtain supplies from any Supplier by any means available in the commercial market.

b. Each Distribution Company with an affiliated Supplier may obtain supplies in one of two ways: First, said Distribution Company may contract for Generation for Basic Service from any Supplier, with the condition that any generation from an affiliated Supplier must be obtained as a result of a competitive bidding process designed along the lines of a day-ahead bidding system, as approved by the Department. The Department may decide whether the day-ahead bidding process shall be administered by a third party not affiliated with the Distribution Company. Second, said Distribution Company may provide distribution

service for supplies to Basic Service Customers from a pool of certified Basic Service Suppliers. The Distribution Company shall use a Department-approved methodology for assigning Basic Service Customers to certified Basic Service Suppliers. The Department shall establish criteria and requirements for certification.

F. Stranded Cost Recovery

CPC fully supports the Department's overall approach to stranded costs. The Department's overall approach includes the two elements which CPC deems to be most essential -- (1) prohibition against recovery of future costs, and (2) the requirement that stranded costs be mitigated. In this section, CPC offers a number of proposals designed to enable the Department to achieve its overall goals.[7]

CPC recommends that the Department include language in the stranded cost recovery regulations that encourage distribution companies with affiliated generation to make good business decisions in the future as to whether to keep those plants in service or to shut them down. We recommend the following language be inserted as 220 CMR 11.03(3)(a)(v)5:

> Collection of stranded costs for a generating asset shall not be predicated on the asset remaining in service after the effective date of these regulations.

CPC also suggests that the Department expand its proposed rule 11.03(3)(a)(iii)5 on mitigation to include standards for estimating the future availability and costs of generating units.

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[7] In these comments, CPC focuses on the larger stranded costs issues raised by the Department's proposed regulations. In its final comments in this docket CPC plans to present more extensive language changes.

CPC is concerned that the methodology proposed for calculating stranded costs provides an incentive for utilities to understate availability and overstate operations and maintenance costs so as to reduce mitigation and increase stranded costs. Clearly, a primary purpose of competition is to provide a very different incentive to suppliers, i.e., to operate units as efficiently and cheaply as possible. CPC therefore recommends that the Department amend the above referenced regulation by inserting the following language at the end of subsection 5:

> a utility's projections of generating facility annual output, life expectancy and generating facility operation and maintenance costs must assume that the facility is operated in a prudent and efficient manner consistent with standards achieved by other units in New England.

CPC also recommends that the Department condition its approval of a utility's stranded cost filing on compliance with this suggested standard and other appropriate standards. Moreover, CPC also requests that the regulations make clear that interested third parties have the opportunity to participate in the Department's review of stranded cost filings. Clearly, parties such as CPC have a compelling interest in the Department's approval of stranded costs. For example, if stranded costs are set too high, utilities will have the ability to artificially underprice competitors in the short-run, thereby inhibiting the formation of a true competitive market. Accordingly, CPC requests that the Department substitute the

following language for the proposed language set forth in 220 CMR 11.03(4)1:

> The Department will review company presentations of stranded cost calculations and mechanisms and will approve or require adjustments to such calculations within 180 days of a company's filing which fully complies with the requirements of these regulations. Subject to the approval of the Department, interested parties will have the opportunity to propound information requests to the company, to examine witnesses and to provide testimony. The Department will approve a company's presentation if it finds at a minimum that (1) the presentation is based on reasonable and consistent projections of market price and future load; (2) the presentation assumes the prudent and efficient performance of generation facilities consistent with the standards achieved by other units in New England; and (3) the presentation incorporates all reasonably available mitigation options.

While CPC endorses the Department's overall approach regarding the calculation of stranded costs, CPC maintains that a somewhat different methodology is appropriate for calculating stranded costs associated with long-term power contracts. Specifically, CPC recommends that it is in the best interest of ratepayers to calculate stranded costs associated with power contracts on an annual basis for the remaining life of the contract. In support of this recommendation, CPC notes that long-term power contracts are different from other kinds of stranded costs in two important ways, and, therefore, warrant different treatment.

First, the cost of a power contract to a utility is largely fixed, and, thus, predictable. For the most part, one needs merely to read a power sales contract to determine what price the

utility must pay in a particular year. Unlike other utility assets, with power contracts there is no need to make uncertain projections about future operation and maintenance expenses. Since the costs associated with a contract are largely known or knowable today, it makes little sense to apply the same stranded cost methodology to power contracts and utility generation, particularly given the wide bandwidths proposed by the Department. And, there would seem to be much less risk to ratepayers of overpayment if the difference between the contract price and the market price were determined at the end of every year.

Second, the obligations of some long-term contracts extend beyond ten years. Requiring the recovery of all the stranded costs associated with a contract within ten years inevitably will increase the size of the stranded cost charge in the early years, assuming that some kind of levelized recovery is used. Again, this result does not seem to be in the best interest of ratepayers.

Accordingly, CPC recommends that the Department amend section 11.03(3)(iv)(1) by adding the following:

> Notwithstanding the projections presented by the company, stranded costs associated with purchase power agreements shall be calculated on an annual basis. At the end of each calendar year, a company shall file with the Department a report showing the difference, if any, between payments made by the company pursuant to a power purchase agreement and the income received from sales of such power. The difference, if any, shall be included in the stranded cost charge for the next year.

CPC also recommends that the Department amend section 11.03(3)(v)(4) of its proposed rules to allow for different treatment of long-term purchase power agreements. (In Section IV.A., below, CPC offers language intended to replace proposed rule 11.03(3)(v)(4) -- language which addresses the power contract issue and other suggested changes.)

CPC's final comments on stranded costs address the Department's questions on the treatment of nuclear plants. In general, CPC believes that nuclear plants warrant no special treatment under the Department's regulations. While it is true that nuclear plants may not be easily divested, this fact only goes to the range of mitigation options that might be available and the amount of stranded cost recovery that might be appropriate. If a utility believes that it cannot operate a nuclear unit safely at competitive market rates, the only solution is to close the plant. Otherwise, consumers will lose some of the advantages of a competitive generation market.

Hence, CPC offers this proposal for consideration by the Department and all the parties: any utility which believes that it cannot operate a nuclear unit safely and reliably at competitive market prices will have the right to petition the Department for approval of an early retirement date for the purpose of rate regulation. That retirement date shall be no later than ten years from the date of the order in this proceeding and shall allow sufficient lead time for the market to bring new resources on line necessary to maintain system

reliability. For the remaining life of the nuclear plant, the Department shall allow some form of cost of service recovery. On the date of retirement, the unit will receive recovery of the undepreciated balance consistent with Department precedent. Decommissioning costs will be treated in a manner consistent with the Department's proposed regulations. The advantage of this proposal is that it seems to permit the orderly retirement of uncompetitive nuclear plants without any risk to public safety or reliability of service. CPC looks forward to discussing this and other options for dealing with nuclear plants during the course of the hearings.

IV. Other Issues

A. Environmental Issues

After arguing in its earlier comments to the Department that the goals of true competition and environmental improvement require comparability in emissions standards that apply to all generating facilities serving Massachusetts consumers, CPC is pleased that the Department stated its desire in D.P.U. 96-100 to establish regulatory policies that are consistent with other efforts at the state, regional, and federal level to achieve environmental quality goals in a restructured industry. See Order at 35-39.

CPC has argued that environmental protection and competition require two things -- first, expeditious movement toward a competitive industry structure that will allow new, efficient, clean plants to compete fairly against and successfully displace

some of the output from older, less efficient, and dirtier generation facilities; and secondly, adoption of "comparable" emissions standards for all plants, so that the older facilities that have been "grandfathered" or held exempt from modern environmental regulation will be subject to the same environmental requirements that more recent plants have had to meet.

In response to the Department's request for comments on what the Department might do to support or encourage the creation of a more level playing field among existing and new sources of generation, CPC offers an approach that could be carried out consistent the Department's authority.[8]

CPC suggests that the Department could lengthen the period of stranded cost recovery from ten years to twelve years for any generating asset or contractual commitment that satisfies modern emissions standards[9] within two years after the effective date of the adoption of the Department's regulations. This lengthened stranded cost recovery period in no way would contribute to a redefinition of stranded costs -- such costs still would only

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[8] In Massachusetts Electric Company v. Department of Public Utilities, 419 Mass. 239 (1994), the Supreme Judicial Court found that the Department has authority *as a rate regulator* to consider the appropriateness of avoiding certain environmental emissions in the future. 419 Mass. at 246.

[9] CPC proposes that the Department use the emission standards included in the Massachusetts Division of Energy Resources' "Power Choice" proposal. (See Power Choice at 31-32.)

include those costs of existing assets and obligations that were incurred by an electric company prior to August 16, 1995.

Rather, the CPC proposal would create an incentive to encourage companies to bring dirty plants up to modern emissions standards. Accordingly, CPC offers the following language to replace proposed rule 11.03(3)(v)(4). This replacement paragraph addresses CPC's new source emissions standards proposal, as well as the treatment of stranded costs associated with power sales contracts, as discussed in Section III.F., above.

The company's collection of stranded costs shall end on December 31, 2007, for all categories of Embedded Costs, with the exception of (a) generating assets with emissions less than or equal to 0.15 pounds per million Btu for average nitrogen oxide emissions, and 0.2 pounds per million Btu for sulfur dioxide emissions; (b) nuclear decommissioning costs; and (c) costs associated with long-term power purchase agreements. For any generating assets meeting the standards set forth in (a), above, by a date no later than 24 months after the effective date of these regulations, the Embedded Costs of such assets may be collected up until December 31, 2009. For costs covered by (b), above, decommissioning costs shall be collected each year until the operating license expiration date that was in effect as of August 16, 1995. For the contracts covered by (c), above, costs shall be collected each year until the termination date of the contract.

Finally, the Department should take whatever steps are necessary to encourage policymakers in state, regional and federal environmental agencies to require environmental comparability. Any effort led by the Department to ensure the cooperation of these environmental agencies is as essential to the success of true competition and environmental protection as are efforts by Massachusetts companies to meet the Department's directives.

B. Renewable Resources

CPC is pleased that the Department is interested in ensuring that renewable resources have a meaningful opportunity to compete in the emerging market for electric energy.

The Department's proposed regulations and Order envision a market where renewable resources will be delivered in three ways: First, suppliers may offer to sell "green energy" directly to consumers as a way to differentiate and market their products to consumers at price and supply terms agreed to by the buyers and sellers. Second, suppliers seeking to supply electricity from new renewable projects with above-market prices can compete to obtain funding for their projects from monies collected from distribution customers through a "renewables" charge. The "renewables" charge would be part of the non-bypassable system access charge assessed against all retail customers. Third, distribution customers with small-scale renewable resources on their sites may run their meters backwards and sell to the distribution company at the spot market price for energy.

CPC views these three approaches as reasonable options for supporting renewable resources. However, at the same time, CPC is concerned that the enormity of this restructuring proceeding will not allow the Department and parties to devote adequate attention to the issues faced by the developers of renewable projects in a restructured industry. In particular, CPC believes that the following three questions regarding renewable projects may not receive the focus they deserve in the course of this

rulemaking proceeding. First, how should "renewable resource" be defined? Second, what portion of the non-bypassable access charge should be allocated to renewable projects on the whole? Third, how should this funding be allocated among renewable projects?

In order to answer these questions and other important questions regarding renewable resources, CPC urges the Department to initiate a separate proceeding devoted exclusively to renewables. Such a docket should be opened on the effective date of the regulations promulgated in D.P.U. 96-100.[10]

In a proceeding dedicated to the restructuring issues faced by renewables developers, the Department will be able to compile valuable data about the current status of various renewable technologies, including information on the maturity of technologies, costs, reliability, environmental impacts, and permitting requirements. This data will enable the Department to develop rules which reflect the current status of renewable technologies, while ensuring that any rules regarding renewables are consistent with the Department's other rules on restructuring.

IV. CONCLUSION

[10] This separate renewables proceeding should be initiated immediately following the effective date of the regulations issued in this case and completed expeditiously in order to avoid chilling the continued development of renewable resources.

CPC appreciates the opportunity to provide the Department with comments on the proposed regulations and looks forward to discussing these amounts with the Department and other parties in the course of this proceeding.